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CENTRAL INTELLIGENCE AGENCY
WASHINGTON, D.C. 20505

CIA/OER/S-06173-74

21 May 1974

MEMORANDUM FOR: Mr. Richard Erb
Council on International Economic
Policy
Old Executive Office Building

SUBJECT : Foreign Economic Prospects in 1974:
Additional Material

1. The attached paper was prepared as a follow-up to our earlier memorandum concerning foreign economic prospects. The estimates presented for Italy reflect consideration of the new import deposit scheme and other recent Italian economic measures.

2. Any updated estimates of economic variables for the major countries will be forwarded for your information as they are completed.

15/
MAURICE C. ERNST
Director
Economic Research

Attachment:
As stated

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Italy

1974 Prospects

We expect Italian real GNP growth to average about 3 1/2% in 1974, with most of the rise occurring in the first half of the year. Strong consumer demand, buoyed by large wage increases late last year, is a major factor in current growth. Recently imposed credit ceilings and the liquidity-reducing impact of the import deposit scheme will curb demand later in the year, provided the Rumor government is able to withstand opposition to its more restrictive stance. These projections are less optimistic than those of the OECD, which were prepared prior to Italy's new economic policies.

The Italian GNP deflator should increase by about 17% this year. Rapid money supply growth last year, the oil price rise, and sharp wage hikes are the chief inflationary factors. Tighter money policies, if continued, will act to slow price rises later in the year, despite higher import costs due to prior import deposits and further lira depreciation. Our inflation projections, nevertheless, are substantially more pessimistic than the OECD's.

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Italy's current account deficit will rise to an estimated \$8.5 billion in 1974. The f.o.b. trade deficit should reach about \$7.5 billion, mainly due to huge net imports of oil and meat items. The services deficit could reach as much as \$1 billion because of sharply higher interest payments on a rapidly rising foreign debt plus some fall-off in net earnings from tourism.

Government Policies

Rome has adopted more restrictive policies in recent weeks but apparently is hoping that its credit and import measures will be selective in their impact. Differences within the governing center-left coalition have ruled out adoption of strongly deflationary policies. Industrial recovery and high employment continue to receive priority. Fiscal policy, which is still moderately expansionary, is not viewed as an effective anti-cyclical tool in Italy.

The lira is expected to depreciate substantially in coming months as the Bank of Italy (BOI) reduces its support of the lira. Declining foreign exchange reserves and foreign financing difficulties will limit the BOI's ability to intervene in the market. Rome is, moreover, under some IMF pressure to allow the lira to decline.

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Italy

	<u>1973</u>	<u>1st Qtr</u> <u>1974</u> <u>Preliminary</u>	<u>1st Half</u> <u>1974</u> <u>Estimated</u>	<u>2nd Half</u> <u>1974</u> <u>Estimated</u>	<u>1974</u> <u>Estimated</u>
	<u>Percentage Change at Annual Rate^{1/}</u>				
GNP (Constant Prices)	5.9	--	2.0	1.0	3.5
GNP Price Deflator	11.0	--	18.0	18.0	17.0
Consumer Prices	12.5	23.2	23.0	21.0	20.0
Wholesale Prices	21.1	--	--	--	--
Money Supply (M1)	20.9	--	--	--	--
	<u>Billion US \$</u>				
Trade Balance (f.o.b./f.o.b.)	-2.6	-2.3	-4.5	-3.0	-7.5
Current Account	-2.8	--	-5.0	-3.5	-8.5
Official Reserves ^{2/}	6.4	6.7	--	--	--

^{1/} Change from previous period^{2/} End of periodCIA/OER
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